No. 85-699

In the Supreme Court of the United States

OCTOBER TERM, 1985

UNITED STATES OF AMERICA, PETITIONER

v.

AMERICAN BAR ENDOWMENT, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

BRIEF FOR THE UNITED STATES

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QUESTIONS PRESENTED

1. Whether income derived by a charitable organization from the sale of group insurance to its members is "unrelated business income" subject to tax under Sections 511 through 513 of the Internal Revenue Code.

2. Whether an insured member of such an organization is entitled to deduct a portion of the premium that he pays for such insurance as a "charitable contribution" under Section 170 of the Code.

PARTIES TO THE PROCEEDING

In addition to the parties named in the caption, Frederick D. Turner (and his wife), Arthur M. Sherwood (and his wife), Herbert C. Broadfoot II (and his wife), and Frederick G. Boynton are respondents.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-23a) is reported at 761 F.2d 1573. The opinion of the Claims Court (Pet. App. 25a-58a) is reported at 4 Cl. Ct. 404. The oral findings of the Claims Court (Br. in Opp. App. A1-A22, B1-B24) are unreported.

JURISDICTION

The judgment of the court of appeals (Pet. App. 24a) was entered on May 10, 1985. On July 31, 1985, the Chief Justice extended the time within which to petition for a writ of certiorari to and including October 7, 1985. The petition was filed on that date and was granted on December 2, 1985. The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

STATUTES INVOLVED

The relevant portions of Sections 501, 511, 512, and 513 of the Internal Revenue Code of 1954 (26 U.S.C.), and of Sections 1.501(c)(6)-1 and 1.513-1 of the Treasury Regulations on Income Tax (26 C.F.R.), are set out at Pet. App. 59a-76a. The relevant portions of Section

170 of the Internal Revenue Code are set out at Br. in Opp. App. C1.

STATEMENT

A. The Facts of These Cases

1. The American Bar Endowment, the corporate respondent, is an organization exempt from tax under Section 501(c)(3) of the Internal Revenue Code.[1] Its main purposes are to advance legal research and to promote the administration of justice. It accomplishes these purposes by making grants to other charitable and educational groups (Pet. App. 26a). All members of the American Bar Association (ABA) are automatically members of the Endowment without paying additional dues. The two organizations, however, are separate legal entities (*id.* at 2a). The ABA is exempt from tax under Section 501(c)(6) as a "business league."

The Endowment was incorporated in 1942, and ABA members were encouraged to make gifts and bequests to it (Pet. App. 26a). Such charitable solicitations, however, generated only "sporadic individual donations" (*ibid.*). In order to raise more substantial sums for its educational endeavors, the Endowment in 1955 proposed "a fundraising plan * * * based upon the sale of group life insurance" (*ibid.*). The *ABA Journal* promoted the program as a means by which members might "enjoy the satisfaction of contributing in a modest way" to the good of the legal profession and "at the same time * * * receive low-cost life insurance protection" (C.A. App. 1395). The ABA also hoped that members would make charitable contributions to the American Bar Foundation, another ABA affiliate, by naming it as a beneficiary of such life insurance policies. The Foundation, however, has never received substantial sums from that source (J.A. 244-245; C.A. App. 1394-1395).

From modest beginnings, the Endowment's insurance operations have grown in size and importance (Pet. App.

[1] Unless otherwise noted, all statutory references are to the Internal Revenue Code of 1954 (26 U.S.C.), as in effect for the tax periods in issue (the Code or I.R.C.).

27a). It offers life, health, accident, and disability coverage underwritten by major insurance companies. Coverage for members' dependents is also available under some plans (*ibid.*). The life insurance plan, the most heavily subscribed, had $2.75 billion of insurance outstanding in 1980. More than 57,000 ABA members—about one-fifth of the total membership—were enrolled in one or more of the plans in that year. A total of 111,260 insurance certificates were then in force (J.A. 93).

The Endowment maintains a staff of 40 people to administer its insurance plans (Pet. App. 27a). It actively supports and officially endorses coverage under the plans, and solicits its members' enrollment through aggressive advertising prepared and distributed by its staff (J.A. 91, 530). It sends promotional literature about its plans to ABA members every year, generating a total of some 1.5 million mailings annually (J.A. 222, 234-236; C.A. App. 1063). These brochures describe the insurance plans in an easy-to-read format, typically referring to the premium charges as "reasonable," "attractive," "affordable," "economic," or "modest" (J.A. 239-240, 241; C.A. App. 988-1012, 1226-1268). According to the Endowment's literature, its disability coverage is "an exceptional insurance value for professional men and women" (*id.* at 1245); its accidental death coverage is "one of the finest values in broad-range accident insurance" (*id.* at 1236); and its major medical plan is "a wise investment in family security" in a time of "soaring" hospital costs (*id.* at 1248-1249).

In addition to these marketing activities, the Endowment's staff performs many tasks essential to administration of the insurance program. It negotiates premium rates with underwriters, negotiates commissions paid to insurance brokers, screens members' application forms, issues certificates of coverage, answers telephone inquiries, maintains files on participating members, bills and collects premiums, forwards premiums to the underwriters, and screens members' claims for benefits (Pet. App. 27a-29a; J.A. 91-92). Nearly all of the Endowment's operat-

ing budget, and between 80% and 85% of its staff's working hours, are devoted to these administrative and promotional activities (J.A. 90, 256).

The Endowment's contracts with its underwriters require the latter to calculate and refund annually to the Endowment, as group policyholder, any policy dividends or retrospective rate credits that accrue to the group policies (J.A. 75-76, 82). These sums, which we shall refer to collectively as "dividends," reflect the excess of the premiums paid by ABA members over the actual cost of coverage—in terms of claims settlement, administrative expenses, and profits—to the underwriters (Pet. App. 3a). In order to enroll in the program, every insured must waive any claim to receive these dividends and must consent to their retention by the Endowment. This condition is stated on the insurance application forms, and the Endownment insists on its strict enforcement (*id.* at 3a-4a, 32a; J.A. 293-295; C.A. App. 1128). When one insured struck the dividend waiver clause from his application form, the Endowment told him that he could not get insurance without accepting the same terms as everybody else (J.A. 293-295; C.A. App. 1135).

The policy dividends that the Endowment receives are the exclusive means of compensating it for the role it plays in marketing and servicing the insurance plans. It applies the dividends, net of its administrative and promotional expenses, to fund its educational projects. Every year, it calculates the percentage of the overall premiums that has been thus applied, and notifies its insured members that they may, in the opinion of the Endowment's counsel, deduct corresponding portions of their own premiums as tax-deductible charitable contributions (Pet. App. 4a, 32a-33a; C.A. App. 867-871). The Endowment's annual reports likewise publicize the insurance program "as a source of charitable contributions" (Pet. App. 36a).

The Endowment's strategy is to maximize the policy dividends and thus maximize its profits. Because ABA members enjoy very favorable mortality and morbidity experience, and because the Endowment negotiates with

the underwriters to make the plans experience-rated, the Endowment could, if it chose, offer insurance at very low premiums, perhaps at rates approaching the cheapest available for group insurance in the country (Pet. App. 30a-32a, 38a; J.A. 189, 220). The underwriters themselves would prefer that members be charged relatively low premiums, with concomitantly small dividends to the Endowment, in the hope of attracting the greatest possible number of participants (Pet. App. 28a). However, while setting the premium charges is technically the prerogative of the underwriters, the Endowment in practice plays a significant role in determining those rates (*ibid.*). The Endowment prefers to set premiums at levels well above the wholesale insurance cost, yet not so high as to discourage participation, so as to maximize the total volume of dividends that it will receive (*id.* at 28a-29a).

In pursuit of this dividend-maximizing strategy, the Endowment uses its leverage with the underwriters to assure that the gross premiums paid by ABA members are comparable to the rates charged for other insurance products available to those individuals in the marketplace (Pet. App. 3a-4a, 27a-30a, 32a). The Endowment regularly reviews the market comparability of its prices and benefits and adjusts its premiums from time to time to keep them competitive (*id.* at 3a, 29a). In 1978, the Endowment conducted a study that compared its premium rates with the prices charged for group insurance offered by state and local bar associations, legal fraternities, alumni organizations, and similar groups (C.A. App. 1378-1384). The study showed that the Endowment's prices, comparatively speaking, were very favorable to the insureds (*ibid.*). In 1980, the Endowment reviewed its rates for hospital and disability coverage and concluded that "[t]he present premium * * * is competitive in the market place and the dividend is excellent, thus fulfilling the purpose of the Endowment to raise funds" (*id.* at 1120, 1121). Based on the recommendation of its underwriter, however, the Endowment concurrently lowered its rates for life insurance so as to "make the life plans com-

petitive in today's market" (J.A. 169, 191-192; C.A. App. 1074-1080, 1119). The Endowment thus takes pains to maintain its premiums within the market range, generating large dividends for itself yet keeping its insurance plans popularly priced (Pet. App. 3a-4a, 28a-29a; J.A. 127-128; C.A. App. 1279, 1282). Any plan not expected to generate large dividends in the long run is discontinued, regardless of its popularity (Pet. App. 32a).

The use of prevailing market rates, coupled with the favorable mortality and morbidity experience of ABA members, has made the Endowment's insurance operations highly profitable. The amounts refunded to it as dividends sometimes exceed 40% of the premiums its members pay (Pet. App. 4a). Income from its insurance operations is by far the major source of its revenue (C.A. App. 1326). Apart from policy dividends and investment income, the only income that the Endowment received during the tax years at issue consisted of charitable contributions to its "memorial fund." These contributions ranged from $395 to $1,495 annually. See C.A. App. 1319. The Endowment's gross insurance revenues, by contrast, aggregated almost $19 million during that period (J.A. 82).

2. The individual respondents are ABA members who bought insurance from the Endowment (Pet. App. 31a, 38a).[2] Each agreed, as a condition of enrollment, that the Endowment could keep any dividends apportioned to his policy (*ibid.*). Each knew, when he wrote his premium checks, that the Endowment would use the dividends to further its work in the legal field.

Respondents Turner and Sherwood signed up for life insurance in 1972. They enrolled after reading brochures explaining that the Endowment's insurance program raised money for educational purposes while offering attractive insurance benefits at a reasonable cost (J.A. 271-273, 277-278; C.A. App. 1027-1034, 1040-1047). The

[2] Respondents' wives are parties solely by virtue of having filed joint income tax returns with their husbands for the relevant tax years.

brochures principally described the "highlights" of the coverage that the Endowment offered for sale, including the option granted to members under 40 (as Turner and Sherwood then were) to be accepted without medical evidence of insurability (*ibid.*).

Respondent Broadfoot initially purchased life insurance in 1971 because, as he testified, "[m]y first child had recently been born and I was interested in obtaining some life insurance" (J.A. 260). He regarded the premiums charged as reasonable, although not necessarily the cheapest on the market (*id.* at 263-264, 269-270). He had once carried a life policy through the Georgia State Bar, but discontinued it after determining that it cost more than the Endowment's (*id.* at 265-267).

Respondent Boynton purchased disability insurance in 1978 (C.A. App. 74). He received promotional literature from the Endowment recommending the disability plan as a "hedge against the constant risk of income loss through disability, * * * with the economy of group rates" (J.A. 285-286; C.A. App. 1233). He concluded after reading the Endowment's literature that its disability coverage was "reasonably or competitive[ly] priced" (*id.* at 287). Before applying for his policy, he examined a number of other disability plans. He found that two offered greater benefits than the Endowment's, but were more expensive (*id.* at 285, 286).

None of the individual respondents testified that, if given an option, he would have elected to assign his policy dividends to the Endowment. None testified that he chose the Endowment's coverage over a cheaper policy in order to further the Endowment's educational goals. None testified that he thought the gross premiums charged by the Endowment exceeded the economic value of the insurance he purchased.

Two nonparty insureds testified that they would have opted to keep their dividends if that election had been offered to them (J.A. 391-392, 393, 454-455). One said that he purchased insurance from the Endowment because he found its premiums competitive and because he

thought that the Endowment "would certainly have the clout to deal with the insurance company" (*id.* at 453). He had personally urged the Endowment to make its insurance even cheaper by returning policy dividends to its members, but he found that the dividend assignment "was not an optional thing. You either agreed to that or didn't get the insurance" (*id.* at 448; C.A. App. 1276, 1277). The other nonparty insured testified that his sole motive for signing up was to obtain insurance (*id.* at 389-392). He chose the Endowment's plan because he did not need to take a medical exam to apply and because he considered the price of the insurance to be reasonable. Like respondent Broadfoot, he had previously held through his state bar association a group life policy that cost more than the Endowment's (*id.* at 389-392, 393, 511-512).

B. The Proceedings Below

1. Sections 511 through 513 of the Internal Revenue Code impose a tax, at regular corporate rates, on the "unrelated business taxable income" of otherwise tax-exempt groups like the Endowment. The tax applies to the net income "derived by any organization from any unrelated trade or business * * * regularly carried on by it" (I.R.C. § 512(a)(1)). An "unrelated trade or business" is one "the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other [tax-exempt] purpose" (I.R.C. § 513(a)). Section 513(c) defines "the term 'trade or business' [to] include[] any activity which is carried on for the production of income from the sale of goods or the performance of services."

During 1979-1981, the tax years at issue, the Endowment's gross revenues from its insurance operations aggregated about $19 million (J.A. 82). On audit, the IRS determined that those revenues, less the Endowment's expenses of promoting and administering the insurance program, were subject to tax as "unrelated business income" (J.A. 83, 90).[3] The Commissioner determined tax deficiencies of approximately $6 million for the three years (*id.* at 83-85).

The Endowment paid the asserted deficiencies and, following denial of its administrative claims for refund, instituted this refund suit in the Claims Court. It conceded that its insurance operations were "regularly carried on" and that the conduct of those operations was "not substantially related" to the achievement of its educational goals (I.R.C. §§ 512(a), 513(a)). See J.A. 94. The Endowment's sole contention was that its insurance operations were not a "trade or business" (I.R.C. § 513(c)). This contention was based on the theory that its insurance activities were not "carried on for the production of income from the sale of goods or the performance of services" (*ibid.*), but rather were carried on as a mere adjunct of charitable fundraising. According to the Endowment, its net insurance revenues were the product of "charitable contribution[s]" that ABA members made by "foregoing the advantage of having premium refunds returned to them" (J.A. 26, 27-28).

2. Section 170(a) of the Code provides an income tax deduction for "charitable contribution[s]." Section 170(c)(2)(B) defines a "charitable contribution" as "a contribution or gift" to or for the use of an entity that is "organized and operated exclusively for religious, charitable * * * or educational purposes." Because the Endowment is tax-exempt under Section 501(c)(3), it is eligible to receive tax-deductible charitable contributions.

None of the individual respondents originally deducted any part of the insurance premiums that he paid the Endowment during 1979-1981 as a "charitable contribution" on his tax return (J.A. 50-52; C.A. App. 64-66, 76-78, 86-89). Thereafter, respondents were invited, and agreed, to take part in this "test case" being mounted

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[3] Since the Endowment devoted its profits to charitable purposes, it was allowed a charitable contribution deduction equal to 5% of its "unrelated business taxable income," the maximum amount then permitted. See 26 U.S.C. (1976 ed.) 512(b)(10).

by the ABA (J.A. 273-274, 284). Each filed an administrative claim for refund, claiming a charitable contribution deduction ranging from 28% to 55% of the premiums he had paid. These percentages depended on the year and type of insurance involved, and were derived from notices issued to respondents by the Endowment (*id.* at 262-263, 272-273, 278-280, 282-283; C.A. App. 868-871). Each sought a refund of $40 or less (J.A. 50-52; C.A. App. 64-66, 76-77, 86-89).

When the IRS demurred, respondents instituted these refund suits in the Claims Court. They contended that each premium they paid to the Endowment was a "dual payment," representing in part the purchase of insurance and in part a charitable contribution (Pet. App. 48a). In computing the charitable-contribution component of each alleged "dual payment," respondents contended that the value of the insurance they bought should be deemed to equal the wholesale insurance price (net of policy dividends) charged by the underwriters, plus the Endowment's out-of-pocket administrative and promotional expenses. Respondents contended, in other words, that they had made charitable contributions in an amount equal to the policy dividends that they were required to waive as a condition of purchasing the insurance, minus their allocable share of the costs incurred by the Endowment.

3. a. The refund suits filed by the Endowment and by the individual respondents were consolidated for trial and decision in the Claims Court. It entered judgment for the government on the charitable contribution issue, holding that none of the individual respondents was entitled to deduct any portion of his premiums (Pet. App. 48a-58a). An insured's "mere awareness" that the Endowment's insurance profits were destined for charitable purposes, the court ruled, was "not sufficient to establish that he made a charitable contribution" (*id.* at 52a). Rather, "[t]o establish a dual payment, the taxpayer must demonstrate that he bought goods or services for more than their economic value, with the intention that the excess be used to benefit [the] charitable enterprise"

(*id.* at 49a). "A corollary to this rule," the court said, "is that there can be no dual payment where the entire amount paid by the taxpayer is economically motivated, that is, where the payment is made to obtain goods or services for which the taxpayer would be willing to pay the full price even absent the charitable contribution" (*ibid.*). Under this standard, the court held, each respondent had to show "that an equivalent insurance product was available to him for a lower price and that he by-passed that product because he wished to make a charitable contribution to the Endowment" (*id.* at 52a (footnote omitted)).

Turning to the facts of the four respondents' cases, the Claims Court concluded that none of them had proved that his purchase of insurance from the Endowment reflected anything other than his own economic interest (Pet. App. 52a-54a). Three of the respondents, the court found, had failed to establish that cheaper insurance was available to them elsewhere (*ibid.*). The fourth, while demonstrating that cheaper insurance existed, offered no proof that he knew about it during the tax years at issue and had elected, for charitable reasons, to buy the Endowment's policy instead (*id.* at 55a-56a). The court noted that the Endowment's advertising was "aggressive" and "in some ways suggested [that its insurance] may be the best deal in the market" (Br. in Opp. App. B14), facts that may have lessened the incentive for ABA members to do exhaustive comparison shopping.

b. While ruling that the individual respondents could not deduct their premiums, the court held that the Endowment's insurance profits were immune from unrelated business income tax on the ground that they did not arise from a "trade or business" (I.R.C. § 512(a)). The statute, the court said, required it "to determine whether [the Endowment was] raising money 'from the sale of goods or the performance of services' or whether the goods or services [were] provided merely as an incident to a fundraising activity" (Pet. App. 34a, quoting I.R.C. § 513(c)). The court held that three factors, taken

together, pointed conclusively in the latter direction (Pet. App. 40a). First, the Endowment's insurance program "was devised as a means for fundraising" and was "so presented and perceived from its inception" (*id.* at 35a). The Endowment's promotional brochures, the court observed, "consistently referred to [its] retention of dividends as donations, not as profits," and it regularly "discussed the insurance program as a source of charitable contributions" (*id.* at 36a).

"Another significant factor," the court said, was "the staggering amount of money consistently generated" by the Endowment's insurance operations (Pet. App. 36a). The court found that these sums were "wholly unrelated to the value of any service [that the Endowment] provided and * * * dwarfed the profit margins of [typical] insurance-related businesses" (*id.* at 40a). "[S]uch profit margins," the court believed, could not "be maintained year after year in a competitive market" (*id.* at 37a).

"The final and most telling factor," in Judge Kozinski's view, was that "the insurance program was operated with the approval and consent of the ABA membership" (Pet. App. 38a). The court noted that the ABA's 300,000 members collectively had the power, by mounting a "grassroots movement" to oust the current leadership, "to change the method of operating the insurance programs" so that members would get the policy dividends back, leaving the Endowment with no profits whatsoever (*id.* at 39a). The most rational explanation of why the membership refrained from doing this, and instead "permitted the Endowment to collect exorbitant revenues," was in the court's view that ABA members "consider the Endowment to be engaged in fundraising, which they support" (*id.* at 41a, 42a). The court emphasized that the Endowment sold insurance exclusively to its members and their dependents, so that the insurance transaction was one "where both buyer and seller are consenting in the sense that one controls the other" (Br. in Opp. App. A11). "[T]he idea of profiting from oneself," the court said, "is almost a contradiction in terms" (*id.* at A13).

The Claims Court accordingly held that "an enterprise that depends on the consent of its customers for its profits is not operating in a commercial manner and is not a trade or business" (Pet. App. 41a).

4. a. The court of appeals affirmed "on the basis of Chief Judge Kozinski's opinion" (Pet. App. 9a) the holding that the Endowment's insurance profits were exempt from tax. It concluded that the Claims Court had "properly found facts" and had "applied the correct standard" to determine whether the Endowment's insurance operations were a "trade or business" (*ibid.*). Based on "the persistent and fundamental fund-raising motivation" of the Endowment's insurance program, "the knowledgeable approval of and consent to the program by the ABA's members," and the Endowment's "phenomenal success" in accumulating policy dividends, the court of appeals was persuaded that the Endowment's activities were not "commercial" and thus were immune from tax (*id.* at 8a-9a). The fact that the Endowment "set out to make as much 'profit' as possible" did not in the court's view determine whether its insurance activities were a "trade or business" (*id.* at 11a). "Unlike what some other courts may do," the court of appeals observed, "this court does not find 'profits,' or the maximization of revenue, to be the controlling basis for a determination of whether the unrelated business tax provisions apply" (*ibid.* (footnote omitted)).

b. On the charitable contribution issue, the court of appeals reversed the Claims Court's judgment and remanded the cases with instructions. It held that the inquiry conducted by the trial court—whether respondents could have obtained comparable insurance coverage for less money—was "an incorrect definitization of the proper standard" (Pet. App. 19a). The Claims Court's approach was wrong, the court of appeals said, because it required affirmative proof of "a charitable motivation of disinterested generosity" (*id.* at 20a (footnote omitted)). The correct legal test, rather, in the court of appeals' view, was "whether the transaction between the

Endowment and the taxpayers * * * was of a business nature and not charitable" based on "all the pertinent circumstances" (*id.* at 21a (original quotation marks omitted)). The court suggested that many ABA members may have signed up for the Endowment's insurance program so that "they could accommodate their insurance needs and at the same time substantially support a worthy charitable goal" (*id.* at 22a). For insureds who fit that description, the court said, it "should not be too difficult" to qualify for a charitable deduction (*ibid.*).

Finding the record "almost completely bare" as to the nature of respondents' dealings with the Endowment, the court of appeals remanded their cases for another trial. Given "the Endowment's persistent and public efforts to enhance its charitable funds," the court said, members who bought insurance from it should be able "to present a *prima facie* case" for a charitable deduction "simply [by] mak[ing] a sworn assertion that they wanted to aid that charitable endeavor and entered the Endowment's plan because it enabled them to do so" (Pet. App. 22a). The government would then have the burden to "controvert that position and [to] suggest factors showing that the transaction was basically business-oriented" (*ibid.*).

On July 17, 1985, the court of appeals stayed proceedings on remand pending this Court's disposition of these cases.

SUMMARY OF ARGUMENT

1. The taxability of the Endowment's insurance activities depends on whether those activities are a "trade or business." Section 513(c) defines a "trade or business" to include "any activity which is carried on for the production of income from the sale of goods or the performance of services." The legislative history makes it clear that Congress intended the term "trade or business" specifically to include a tax-exempt organization's operation of a group insurance program for its members.

The Endowment's insurance activities clearly satisfy each element of the definition set forth in Section 513(c).

First, those activities comprise both "the sale of goods" and "the performance of services." The Endowment sells various insurance products at retail and performs a variety of ancillary promotional and administrative services. Second, the Endowment carries on its activities "for the production of income," that is, to make a profit. The courts below correctly found that the Endowment's insurance activities are highly profitable and are consciously structured to be so. Third, the Endowment carries on its activities in order to make a profit "from" the insurance goods that it sells and "from" the insurance services that it performs. It was for the express purpose of profiting therefrom that the Endowment in 1955 proposed "a fund-raising plan * * * based upon the sale of group life insurance" (Pet. App. 26a). Because the Endowment sells insurance at fair market retail prices, and because it requires members to waive any claim to policy dividends as a condition of buying the insurance, the money that it makes necessarily arises "from" its insurance operation.

The Endowment's insurance operation, moreover, falls squarely within the policy of the unrelated business income tax. By marketing its insurance "as a source of charitable contributions" (Pet. App. 36a), the Endowment encourages ABA members to buy insurance from it, rather than to buy comparably-priced insurance from its competitors, on the theory that the after-tax cost of its insurance is substantially lower. In thus seeking to exploit its tax-exempt status to the detriment of other vendors of insurance in the marketplace, the Endowment exemplifies the very problem of "unfair competition" (H.R. Rep. 2319, 81st Cong., 2d Sess. 36 (1950)) at which the unrelated business income tax was aimed.

2. To be entitled to deduct a portion of their insurance premiums as a "charitable contribution," the individual respondents were required to prove (a) that the gross premiums they paid the Endowment exceeded the fair market retail value of the insurance they received in exchange, and (b) that they paid such "excess" with the

intention of making a gift. The Claims Court correctly held that respondents had failed to carry their burden of proof in one or both respects. Respondents' argument in essence was that the "value" of the insurance they bought should be deemed to equal, not its fair market retail value, but its cost to the Endowment. That is not, and has never been, the law.

The Federal Circuit, while accepting the Claims Court's basic findings of fact, concluded that respondents might nevertheless claim a deduction based simply on the assertion that they intended to support a worthy charitable goal, while at the same time accommodating their own insurance needs. That conclusion was erroneous, for it ignores the substantial economic equivalence between what respondents paid for and what they got.

ARGUMENT

I. INCOME DERIVED BY A CHARITABLE ORGANIZATION FROM MARKETING AND ADMINISTERING A GROUP INSURANCE PROGRAM FOR ITS MEMBERS IS SUBJECT TO TAX AS UNRELATED BUSINESS INCOME

A. The Term "Trade or Business" Includes Any Activity Regularly Carried On With The Intention of Making A Profit From The Sale Of Goods Or The Performance Of Services, And Congress Intended That This Definition Would Embrace Insurance Activities Of The Type Carried On By Respondent

1. The background of the unrelated business income tax, explained more thoroughly in our brief in *United States* v. *American College of Physicians*, No. 84-1737, may be summarized here. Before that tax was enacted, charitable organizations that carried on ordinary trades or businesses were able to escape tax on their profits on the theory that the charitable "destination" of the revenues took precedence over their commercial "source." Thus, a nationwide vendor of macaroni (*C.F. Mueller Co.* v. *Commissioner*, 190 F.2d 120 (3d Cir. 1951)), and a commercial bathing beach facility (*Roche's Beach, Inc.* v. *Commissioner*, 96 F.2d 776 (2d Cir. 1938)), successfully claimed tax-exempt status simply because their business profits went to charity.

In 1950 Congress responded to that situation in two ways. First, it enacted the so-called "anti-feeder" provision (I.R.C. § 502(a)), which precludes organizations "operated for the primary purpose of carrying on a trade or business for profit" from claiming tax exemption solely on the ground that their profits go to charity. Second, Congress enacted the "unrelated business income tax," now codified in Sections 511 through 515 of the Code. Those provisions generally require any organization that otherwise qualifies for tax exemption to pay tax at regular corporate rates on income derived "from any unrelated trade or business * * * regularly carried on by it" (I.R.C. § 512(a)(1)).

The chief impetus behind the new tax was Congress's desire to put the business operations of tax-exempt organizations on an equal footing with those of their tax-paying commercial counterparts. The House Report stated that "[t]he problem at which the tax on unrelated business income is directed * * * is primarily that of unfair competition." H.R. Rep. 2319, 81st Cong., 2d Sess. 36 (1950). The tax generally falls on business revenues, not on membership dues or investment income, because Congress regarded such passive sources of funding as a traditional and proper mainstay for charitable institutions, one that was "not likely to result in serious competition for taxable businesses" (S. Rep. 2375, 81st Cong., 2d Sess. 30-31 (1950)).

The unrelated business income tax, as enacted in 1950, did not include a definition of the term "trade or business." The legislative history made clear, however, that the phrase "has the same meaning as it has elsewhere in the [C]ode, as, for example, in [the predecessor of Section 162(a)]," which authorizes deductions for expenses incurred in "carrying on any trade or business." See H.R. Rep. 2319, *supra*, at 109; S. Rep. 2375, *supra*, at 106. The indicia of a "trade or business" for purposes of Section 162(a) have always included the regularity, continuity and extensiveness of the taxpayer's commercial activities. See, *e.g.*, *McDowell* v. *Ribicoff*, 292 F.2d 174,

178 (3d Cir. 1961). "It is well established," however, "that the existence of a genuine profit motive is the most important criterion for the finding that a given course of activity constitutes a trade or business." *Lamont* v. *Commissioner*, 339 F.2d 377, 380 (2d Cir. 1964) (citing cases). Accord, *e.g.*, *Hirsch* v. *Commissioner*, 315 F.2d 731, 736 (9th Cir. 1963); *Bessenyey* v. *Commissioner*, 379 F.2d 252, 256 (2d Cir. 1967); *Iowa State University* v. *United States*, 500 F.2d 508, 522 (Ct. Cl. 1974).

In 1967, the Treasury promulgated regulations defining a "trade or business" for purposes of the unrelated business income tax. Treas. Reg. § 1.513-1, 32 Fed. Reg. 17657 (1967). The regulations stated that any activity "which is carried on for the production of income and which otherwise possesses the characteristics required to constitute [a] 'trade or business' within the meaning of section 162 * * * presents sufficient likelihood of unfair competition to be within the policy of the tax" (Treas. Reg. § 1.513-1(b)). "Accordingly," the Treasury concluded, "for purposes of section 513 the term 'trade or business' has the same meaning it has in section 162, and generally includes any activity carried on for the production of income from the sale of goods or performance of services" (*ibid.*).

These regulations provoked considerable controversy, chiefly because they permitted a tax-exempt group's activities to be "fragmented" into unrelated-business and exempt-purpose components. See U.S. Br. at 15-24, *United States* v. *American College of Physicians*, No. 84-1737. Congress resolved this controversy in 1969 by codifying the regulations' definition of "trade or business." Tax Reform Act of 1969, Pub. L. No. 91-172, 83 Stat. 487 *et seq.* Congress explicitly stated its intention "to make clear that such regulations are valid" and its determination that they "should be placed in the tax laws." H.R. Rep. 91-413, 91st Cong., 1st Sess. Pt. 1, at 44 (1969); S. Rep. 91-552, 91st Cong., 1st Sess. 75 (1969). Effectuating that aim, Congress in 1969 added to the Code a new Section 513(c). It provides that, "[f]or purposes of this section, the term 'trade or business' includes any activity which is carried on for the production of income

from the sale of goods or the performance of services." Tax Reform Act of 1969, Pub. L. No. 91-172, § 121(c), 83 Stat. 542.

2. The legislative history of Section 513(c) itself sheds little light on the types of activities (aside from commercial advertising) that Congress believed would constitute a "trade or business" as there defined. In discussing related provisions of the 1969 Act, however, Congress had occasion to address the conduct of insurance operations by various types of tax-exempt groups. The legislative history of those provisions makes it clear that Congress intended the term "trade or business" to include an organization's operation of a group insurance program for its members.

a. Prior to 1969, many categories of tax-exempt groups were not subject to the unrelated business income tax. Organizations so immune included churches, social welfare organizations, social clubs, fraternal beneficiary societies, and voluntary employees' beneficiary associations. See H.R. Rep. 91-413, *supra*, at 47. Congress found that the exclusion of these groups from the tax had led to abuses, such as "churches [becoming] involved in operating chains of religious bookstores, hotels, factories, * * * parking lots, record companies, groceries, bakeries, cleaners [and] candy sales businesses" (*ibid.*). Congress accordingly determined to "extend[] the unrelated business income tax to virtually all exempt organizations" (*ibid.*). It did so by amending Section 511(a) of the Code. Tax Reform Act of 1969, Pub. L. No. 91-172, § 121(a)(1), 83 Stat. 536.

Several categories of organizations to which the tax was thus extended, such as fraternal beneficiary societies, had long been specifically authorized by the Code to conduct insurance programs as part of their tax-exempt mission. This authorization had been accomplished by providing, in Section 501(c), that the tax-exempt function of such a group included "providing for the payment of life, sick, accident, or other benefits to [its] members * * * or their dependents." See 26 U.S.C. (1964 ed.) 501(c)(8) (fraternal beneficiary societies), 501(c)(9) (voluntary employees' beneficiary associations). In

extending the unrelated business income tax to such groups, Congress took pains to make clear that the tax would not apply to their insurance activities, inasmuch as those activities were defined by statute to be "substantially related" to their tax-exempt goals. As the Senate Report put it (S. Rep. 91-552, *supra*, at 68):

> The bill continues to exclude from unrelated business income earnings from businesses related to an organization's exempt function—such as the earnings received directly or indirectly from its members by a fraternal beneficiary society in providing * * * insurance benefits for its members or their dependents. For example, if the fraternal beneficiary society directly provides insurance for its members and their dependents, or arranges with an insurance company to make group insurance available to them, the amounts received by the society from its members for providing, or from the insurance company for arranging, for this exempt function will continue to be excluded from the unrelated business income tax.

The House Report stressed the same point. "In extending the unrelated business income tax to virtually all exempt organizations," that Report stated, "the bill continues to exclude * * * earnings from businesses related to an organization's exempt function—such as an insurance business run by a fraternal beneficial association for its members" (H.R. Rep. 91-413, *supra*, at 47).

This legislative history makes it clear that Congress, in enacting Section 513(c), contemplated that a tax-exempt group's operation of an insurance program for its members would come within the term "trade or business" as there defined. As noted above, both the House and the Senate Reports explicitly refer to such insurance activities as a "business." H.R. Rep. 91-413, *supra*, at 47; S. Rep. 91-552, *supra*, at 68. Obviously, if Congress had intended that insurance activities *not* be deemed a "trade or business," it could have said that insurance income in general would be immune from tax for that reason. Instead, Congress limited its discussion to those tax-exempt groups that Section 501(c) expressly authorizes to provide insurance, and stated that those groups' insurance income would be immune from tax because it was derived from "substantially related" activities. The unmistakable inference is that running an insurance program for members *is* a "trade or business," and that, if the conduct of that business is not "substantially related" to the group's tax-exempt purpose—as in the Endowment's case it concededly is not—the insurance income is subject to tax.

b. The conclusion that Congress regarded insurance operations as a "trade or business" is further supported by actions it took a few years later. Congress recognized in 1972 that the 1969 Act had unintentionally created a problem for veterans' groups, some of which "provide[d] one or more types of insurance for their members and the dependents of their members." S. Rep. 92-1082, 92d Cong., 2d Sess. 2 (1972). As the Senate Report noted (*ibid.*), the insurance programs of veterans' groups took several forms:

> In some cases the organizations serve as commissioned agents for insurance companies which provide the actual insurance for the organizations' members and their dependents. In such a case, the organization receives portions of the premiums paid by its members for the insurance. In other cases, veterans' organizations receive income from their own provision of insurance benefits for their members and dependents, that is, they are self-insurers.

As of 1969, veterans' organizations were not specifically enumerated in Section 501(c) as a distinct category of tax-exempt group. Rather, they typically qualified for tax exemption as a "social welfare organization" under Section 501(c)(4), or as a "social club" under Section 501(c)(7). See S. Rep. 92-1082, *supra*, at 2. The tax-exempt purposes of groups in those two categories, of course, had never been defined to include the conduct of insurance programs. Since veterans' groups thus lacked any obvious basis for contending that their insurance operations were "substantially related" to their exempt functions, the 1969 Act appeared to subject their insurance profits to unrelated business income tax (S. Rep. 92-1082, *supra*, at 2-3).

Congress responded to this problem in 1972. Act of Aug. 29, 1972, Pub. L. No. 92-418, 86 Stat. 656 *et seq.* Congress noted that, under the 1969 Act, "income from insurance activities of fraternal beneficiary associations would be exempt from the unrelated business income tax," and it concluded "that there was no reason not to provide similar treatment for * * * veterans' organizations" (S. Rep. 92-1082, *supra*, at 3). Congress accordingly added a new Section 501(c)(19) to the Code, specifically listing veterans' groups, for the first time, as a distinct category of tax-exempt group. Pub. L. No. 92-418, § 1(a), 86 Stat. 656. Congress then established "a special rule for * * * veterans' organizations for the income they receive from providing insurance benefits" (S. Rep. 92-1082, *supra*, at 5). This "special rule" was accomplished by adding Section 512(a)(4) to the Code, defining the "unrelated business taxable income" of a veterans' group to exclude "any amount attributable to payments for life, sick, accident, or health insurance with respect to [its] members * * * or their dependents." Pub. L. No. 92-418, § 1(b), 86 Stat. 656. See I.R.C. § 512(a)(4), cross-referring to I.R.C. § 501(c)(19). Finally, Congress determined that, since "there was no specific intent to tax the insurance income of veterans' organizations by the 1969 Act" (S. Rep. 92-1082, *supra*, at 4), the 1972 amendments should be made retroactive to December 31, 1969, the effective date of the 1969 legislation. Pub. L. No. 92-418, § 1(c), 86 Stat. 656.

These actions of Congress in 1972 confirm the conclusion that it regarded the insurance activities of tax-exempt groups as a "trade or business." Were that not so, there would have been no need to enact the 1972 legislation respecting veterans' groups at all. And unless Congress believed that the insurance profits of veterans' groups would have been subject to unrelated business income tax under a literal reading of the 1969 Act, Congress would scarcely have taken the rather unusual step of making the 1972 law retroactive to a date two years and nine months earlier.

B. Because Respondent Engaged In A Regular And Extensive Course Of Commercial Activities With The Intent To Make A Profit, Its Insurance Operations Are A "Trade Or Business" And Its Insurance Income Is Subject To Tax

1. In holding that the Endowment's insurance activities are immune from unrelated business income tax, the courts below ignored the plain language of Section 513(c), as well as the import of the legislative history just discussed. The statute unequivocally states that "the term 'trade or business' includes any activity which is carried on for the production of income from the sale of goods or the performance of services" (I.R.C. § 513(c)). The Endowment's insurance activities satisfy each element of this definition.

First, the Endowment's insurance activities obviously comprise both "the sale of goods" and "the performance of services." The Endowment sells various insurance products at retail, including participation in group life, health, accident, and disability plans (Pet. App. 27a, 29a). And it performs valuable services first and foremost by putting together a group of above-average insurance risks, and then by selecting and negotiating with the underwriters, assembling a package of group policies, endorsing, promoting, and marketing that package to its members, screening its members' applications, answering their inquiries, billing and collecting their premiums, and discharging a host of other day-to-day tasks essential to the functioning of the program (J.A. 82-83, 90, 91-92). Indeed, its staff of 40 runs the business in much the same way that most insurance brokers, plan administrators, and other financial intermediaries run theirs.

Secondly, the Endowment carries on its insurance program "for the production of income," that is, in order to make a profit. Both courts below found that the Endowment's insurance program is highly profitable and that it is consciously structured to be so. The Endowment's strategy is "to operate only those insurance plans capable of generating substantial dividends" (Pet. App. 28a,

29a). The Endowment "assure[s] that the ABE insurance plans [are] experience rated," and it causes the underwriters to "set the premiums as high as possible without discouraging participation," so that it in turn can "benefit from the high dividends it c[an] recoup as a result of the generally favorable morbidity and mortality experience" of ABA members (*id.* at 4a, 28a-29a, 31a). The Endowment "gain[s] the benefit of the float on a portion of the premiums," it "avoid[s] charges for a certain type of [insurance] reserve," and it otherwise "use[s] the size and prestige of [its] account to vigorously negotiate the most advantageous possible cost structure for each of the insurance plans" (*id* at 31a-32a). These facts show that the Endowment follows the same strategy "for the production of income" (I.R.C. § 513 (c)) that has been used by successful businesses since the beginning of time—"cutting costs" while "keeping gross premiums [as] high" as the market will bear (Pet. App. 28a, 31a-32a).

Finally, it is obvious, contrary to respondent's contention (Br. in Opp. 10-11), that the Endowment carries on its insurance activities in order to make a profit "from" the insurance goods that it sells and "from" the insurance services that it performs. It was for the express purpose of profiting therefrom that the Endowment set up the insurance program in 1955. For the first 13 years of its existence, the Endowment had tried to raise money by asking ABA members voluntarily to make charitable contributions to it. As the Claims Court found (Pet. App. 26a), however, these charitable solicitations generated only "sporadic individual donations." Having found itself unable to raise through charitable solicitations the volume of funds that it desired, the Endowment in 1955 proposed "a fundraising plan * * * based upon the sale of group life insurance" (*ibid.*). In structuring that plan, the Endowment required ABA members, as an absolute condition of purchasing insurance, to waive any claim to policy dividends. If the Endowment had instead

consented to rebate the dividends to its members, coupling such rebates with a request that the members voluntarily contribute the dividends back to it, it would have a strong claim that funds thus contributed were derived "from" charitable solicitations rather than "from" its insurance business. Instead, the Endowment required members to waive their dividends, and it set their gross premiums "at a level competitive with other insurance on the market" (*id.* at 4a), so that the *entire amount* the members paid was a *premium* payment for *insurance.* Thus, whether one views the Endowment as ultimately being compensated by its members (via premiums) or by the underwriters (via dividends), the payments it receives are *insurance-related payments* that necessarily arise *from its insurance-related activities.*

In sum, the Claims Court's factual findings show that the Endowment, like any middleman, endeavors to and does earn profits from buying at wholesale, selling at retail, and rendering the ancillary services necessary to that sales operation. Those findings establish that the Endowment's insurance activities are "carried on for the production of income from the sale of goods or the performance of services" (I.R.C. § 513(c)). That fact, under the governing statute, compels the conclusion that respondent is in a "trade or business."

2. Consistently with what we believe to be the proper construction of Section 513(c), the Fourth, Fifth, and Sixth Circuits have held that a tax-exempt business league's operation of a group insurance program for its members is a "trade or business" if the program is carried on to earn a profit. See *Carolinas Farm & Power Equipment Dealers* v. *United States*, 699 F.2d 167 (4th Cir. 1983); *Louisiana Credit Union League* v. *United States*, 693 F.2d 525 (5th Cir. 1982); *Professional Insurance Agents* v. *Commissioner*, 726 F.2d 1097 (6th Cir. 1984). The organizations involved in these cases were tax-exempt associations which, like the Endowment, drew their members exclusively from a single trade or profession. Like the Endowment, each operated a group in-

surance program for its members, "serv[ing] as a middleman between [its] member[s] * * * and commercial vendors of insurance" (*Louisiana Credit Union League*, 693 F.2d at 528). In its capacity as middleman, each association performed a variety of "promotional and administrative services" (*Professional Insurance Agents*, 726 F.2d at 1100). It selected the insurance underwriter; served as group policyholder; actively supported and officially endorsed the insurance program; distributed informational brochures to its members; answered members' telephone inquiries and otherwise marketed the program; processed its members' application forms and requests for changes in coverage; sent premium notices to its members, collected their premium checks, and forwarded the premiums to the underwriters; and generally "performed the day-to-day administrative tasks essential to the insurance * * * operations." *E.g.*, *Louisiana Credit Union League*, 693 F.2d at 533. Like the Endowment, each association received substantial rebates from the insurance carriers, computed either as experienced-rated refunds or as a flat percentage of members' gross premiums. *Id.* at 528; *Professional Insurance Agents*, 726 F.2d at 1100-1101; *Carolinas Farm & Power Equipment Dealers*, 699 F.2d at 168. Each association, like the Endowment, earned large amounts of insurance-related income, yet contended that its insurance activities did not constitute a "trade or business" within the meaning of Section 513(c).

The court of appeals in each case squarely rejected that argument. In *Louisiana Credit Union League*, the Fifth Circuit held that the key question under Section 513(c)'s definition of a "trade or business" is whether the organization "had a profit motive for its activities" (693 F.2d at 532-534). As the court put it (*id.* at 532):

> We believe that the "profit motive" standard is the proper one to be applied in this case, for it is consistent with the plain language of section 513 as well as the accompanying regulations. The statute, which clearly encompasses within its parameters any activity "carried on for the production of income," first raises the issue of motive. The regulations, which invoke section 162 and its "profit motive" gloss, confirm that motive is the key inquiry. Thus, to determine whether a tax-exempt organization is carrying on a trade or business, the court must look to see whether that institution is engaged in extensive activity over a substantial period of time with the intent to earn a profit.

The record in that case indicated that the association had "extensive involvement in insurance * * * activities" and that it engaged in them "primarily because [they] produced revenue necessary to finance [its] operations" (*id.* at 532-533). These facts, the Fifth Circuit explained, showed the existence of a "trade or business" (*id.* at 533):

> [The association] did everything short of actually selling the insurance * * * itself: it selected the companies whose products and services would be endorsed, actively marketed and promoted those products and services to [its] member[s] * * *, and performed the day-to-day administrative tasks essential to the insurance * * * operations. More comprehensive involvement would be difficult to imagine. As reflected by the [association's] receipts for the years in issue, [it] was amply rewarded for its efforts—its activities were highly profitable, and those profits were increasing. We agree with the district court that the [association] had the "profit motive" for its insurance * * * activities necessary to a finding of a trade or business * * *.

In *Carolinas Farm & Power Equipment Dealers*, the Fourth Circuit likewise held, on substantially identical facts, that "the proper inquiry is whether an organization conducts an activity to earn a profit. If so, the activity is a trade or business" (699 F.2d at 169). The court observed that the association "consistently received far more in rebates than it expended in providing insurance services" and that its insurance operations were "highly

profitable" (*id.* at 170). Where a tax-exempt group conducts commercial activities "in a competitive profit-seeking manner and regularly earns significant profits," the court held (*id.* at 171),

> a heavy burden must be placed on the organization to prove [that] profit is not its motive. Certainly where, as here, an organization could easily rebate any profits to its members and thus * * * provid[e] them with even lower cost group insurance, that burden must be held unmet.

In *Professional Insurance Agents*, the Sixth Circuit explicitly followed these decisions and held that Section 513(c) "requires us to examine the exempt organization's underlying reasons for engaging in the questioned activity. If it has as its motive the production of income, the activity constitutes a trade or business" (726 F.2d at 1102). The court of appeals examined the marketing, administrative, and promotional activities that the association had undertaken to support the insurance program, and concluded that it had "engaged in extensive activity over a substantial period of time with intent to earn a profit" (*ibid.*). The court accordingly held that the association's "motive for offering the insurance policies at issue * * * was one of profit sufficient to support a finding that the premiums it received were from a trade or business" (*ibid.*).

3. In declining to follow these cases, neither the Claims Court nor the Federal Circuit contended that they were wrongly decided. Rather, both courts "found these cases to be inapposite, primarily because they involved insurance plans run by business leagues rather than charitable organizations" (Pet. App. 10a, 43a-44a). But this difference, upon which respondent also relies (Br. in Opp. 14-16), is wholly irrelevant to the issue at hand; the cases are for all intents and purposes indistinguishable.

a. Respondent appears to agree (Br. in Opp. 15-16) that the Fourth, Fifth and Sixth Circuit cases cannot be distinguished from this one on the purely formal ground that the groups selling insurance there were tax-exempt

as "business leagues" under Section 501(c)(6), whereas the Endowment is tax-exempt as an "educational association" under Section 501(c)(3). That concession is appropriate. As we have argued at greater length in *United States* v. *American College of Physicians* (84-1737 U.S. Br. at 33-40), the subsection of Section 501(c) under which a professional group happens to be organized makes no difference in determining the taxability of its profit-motivated activities. Section 513(c)'s definition of "trade or business" applies to *all* tax-exempt groups. Under that definition, it is the nature of the *activities* conducted by the group, not the source of its exemption, that determines whether it is in a "trade or business." Any formal distinction along these lines would be particularly inappropriate here, since the Endowment is a charitable affiliate of the ABA, which is *itself* a Section 501(c)(6) business league. Neither law nor logic could justify a theory under which the Endowment's insurance program would be a "trade or business" if run by the ABA, yet cease to be a "trade or business" because run by the Endowment. Such a theory would enable any tax-exempt group to avoid taxation of its business profits simply by spinning the business off into a Section 501(c)(3) sister corporation, a result that would make payment of the unrelated business income tax elective.

b. While correctly conceding that business leagues and charities should not "be treated differently for purposes of section 513 *if they are operating in the same manner*" (Br. in Opp. 15-16 (emphasis in original)), the Endowment argues that its mode of operation differs from that of the business leagues we have described. Respondent acknowledges, as it must, that its full-time staff of 40 perform during their working day substantially the same promotional, administrative and sales tasks whose aggregation the Fourth, Fifth and Sixth Circuits have held to be a "trade of business" (see *id.* at 12-14). But respondent says that the groups involved in those cases "performed services for an insurance carrier and [were] paid * * * by the insurance carrier," whereas the Endow-

ment performed services for its members and was paid by them (*ibid.*).

This contention is wholly beside the point. Like the business leagues described above, respondent "serves as a middleman between [its] member[s] * * * and commercial vendors of insurance." *Louisiana Credit Union League*, 693 F.2d at 528; Pet. App. 47a. Like those business leagues, respondent receives sizable rebates or dividends from the insurance carriers. Contrary to respondent's contention, it is immaterial who—as between the members and the underwriters—should be viewed as the "source" of this money in some ultimate economic sense. A middleman in the nature of things performs services for both the buyer and the seller; he may be paid by the buyer, the seller, or both. In determining whether he is in a "trade or business," it is irrelevant who remunerates him. The point is that the Endowment, like the business leagues we have discussed, sells a variety of insurance-related goods and performs a variety of insurance-related services, the result of which is that it receives, through a combination of payments from its members and its underwriters, a substantial volume of insurance-related income. Respondent is thus "operating in the same manner" (Br. in Opp. 16) in which those business leagues operated.

c. Finally, respondent follows the courts below (Pet. App. 10a, 44a) in seeking to distinguish the cases we have discussed on the ground that the groups selling insurance there, being "business leagues," were incapable of the "charitable fundraising" that respondent asserts to be the true source of its revenues. See Br. in Opp. 14-15. As the Claims Court put it, "Once it is shown that a 501 (c) (6) organization is engaging in an income-producing enterprise, the activity must *perforce* be deemed a business because such organizations do not engage in charitable fundraising" (Pet. App. 44a (emphasis added)).

This argument is illogical. It is of course true that a business league for its own purposes cannot engage in

charitable fundraising, because a business league is not a charity. But a business league is perfectly capable of engaging in fundraising for the various worthwhile purposes that constitute the basis of its tax exemption. See 4 B. Bittker, *Federal Taxation of Income, Estates and Gifts* ¶ 102.3.2 (1981). The business leagues involved in the cases we have discussed thus had available to them the same argument—that their insurance operations were not a "trade or business" but were merely an adjunct of "tax-exempt fundraising"—that the Endowment makes here. Indeed, the Fifth and Sixth Circuits noted that the insurance operations of a Section 501(c)(6) group "are basically a fundraising activity," but they held that such activity is nonetheless an unrelated "trade or business." *Professional Insurance Agents*, 726 F.2d at 1104; *Louisiana Credit Union League*, 693 F.2d at 537.

C. The Justifications Advanced By The Courts Below Do Not Support Their Decision To Exempt Respondent's Insurance Profits From Unrelated Business Income Tax

The courts below adduced four principal arguments to support their conclusion that the Endowment is not running a "trade or business." First, they reasoned that the insurance program is "presented" by the Endowment and "perceived" by its members as "a fundraising activity" (Pet. App. 8a-9a, 35a-36a). Second, they said that the Endowment's profits are "astounding" and have "far exceeded the value of any services which it might have performed" (*id.* at 8a-9a, 36a-40a). Third, they reasoned that the Endowment needed the "consent to the program by the ABA's members" and that "an enterprise that depends on the consent of its customers for its profits * * * is not a trade or business" (*id.* at 8a, 41a). Finally, they asserted that the Endowment's insurance venture has "an entirely procompetitive effect" and "does not represent the sort of enterprise at which the unrelated business income tax [is] directed" (*id.* at 9a, 47a-48a). There is no merit to any of these theories.

1. In determining whether the Endowment is running a "trade or business," it is legally irrelevant that its promotional materials "consistently refer[ ] to [its] charitable endeavors" and describe the insurance program as "a fundraising activity" (Pet. App. 36a). "Fundraising," after all, is just a synonym for "making money." Whenever a charity makes money, from an unrelated business or otherwise, its activity can be styled "charitable fundraising" because the income is destined for—indeed, must, if the charity is to retain its exemption, be used exclusively for—charitable purposes. The profits that NYU once made by selling spaghetti through its macaroni factory (*C.F. Mueller Co.* v. *Commissioner*, *supra*), could equally have been labeled "charitable fundraising," since the funds financed education.

It is likewise immaterial that the Endowment's members may approve of its charitable endeavors, may know that their premiums help finance those endeavors, and may choose its insurance over a comparably-priced competitor's because they want those endeavors to thrive. People who bought spaghetti from NYU's macaroni company rather than from its competition may well have known that part of their purchase price would "go to charity," and may well have been motivated by the thought that NYU would at least make good use of the money. But Congress in 1950 dictated the irrelevance of these facts by enacting the unrelated business income tax, which aims to prevent tax-exempt groups from gaining a subsidy to the detriment of their taxpaying competitors in the marketplace, and which accordingly focuses on the *source*, not on the *destination*, of a charity's income. The rationale of the courts below—that the Endowment's insurance profits represent "charitable fundraising"—simply begs the question, which is not whether the Endowment raises funds for charitable purposes, but whether it raises funds for charitable purposes by running a "trade or business." As commentators on the Claims Court's decision have noted, "the court's emphasis on the destination of the profits for charitable purposes is wholly at variance with the genesis of the tax." Schwarz & Hutton, *Recent Developments in Tax-Exempt Organizations*, 18 U.S.F.L. Rev. 649, 684 (1984).

Finally, the fact that the Endowment "refer[s] to [its] retention of dividends as donations" and describes the insurance program "as a source of charitable contributions" (Pet. App. 36a), far from supporting a decision to immunize it from unrelated business income tax, points in precisely the opposite direction. By marketing the program in this way, the Endowment encourages ABA members to buy insurance from it, rather than to buy comparably-priced insurance from its competitors, on the theory that the *after-tax* cost of *its* insurance is substantially lower. In thus seeking to exploit its tax-exempt status to gain a competitive edge over other sellers of insurance in the marketplace, the Endowment exemplifies the very problem of "unfair competition" (H.R. Rep. 2319, *supra*, at 36) at which the unrelated business income tax was aimed.

2. The Federal Circuit's suggestion that the "phenomenal" and "astounding" profitability of the Endowment's insurance program *negates* its trade-or-business status (Pet. App. 8a) turns Section 513(c) on its head. The key criterion for assessing the existence of a "trade or business" under Section 513(c) is whether the organization has a genuine motive to earn a profit. One would have thought that a motive, successfully executed, to earn extraordinarily large profits by selling goods or services at competitive market prices would make an activity more of a trade or business, not less of one.

Contrary to the statements of the courts below (Pet. App. 8a, 37a), moreover, it is irrelevant that the Endowment generates its profits by realizing a high profit margin on its existing volume of sales, rather than by realizing a lower profit margin on what could be a much larger volume of sales. Economically speaking, the Endowment's insurance operation functions as a business set up to exploit a very valuable, but virtually cost-free, asset—a pool of potential insureds, all ABA members,

who have far-above-average mortality and morbidity experience. The Endowment could elect to exploit this asset in at least two ways, depending on its marketing strategy. It could charge below-market premiums, maintaining a modest level of profitability per insured but attracting a big market share. If it did that (as its underwriters surely wish it would), many more lawyers might join the ABA and buy insurance from the Endowment, since its premiums would be among the lowest anywhere. If the Endowment chose to run its insurance business in that way, it would make its profits (as do supermarkets) on volume, and would clearly—even under the decision below, presumably—have to pay unrelated business income tax on those profits.

Alternatively, the Endowment could elect, as it in fact did, to charge market-level premiums, maintaining a high level of profitability per insured but settling for a more modest market share. On this approach, some lawyers will decide to buy insurance elsewhere, the Endowment's prices being roughly equivalent—ignoring for the moment the Endowment's promise of a tax-deductible charitable contribution—to the prices charged in the marketplace generally. But the Endowment will make lots of money on the lawyers who pick it. That is what the Endowment has chosen to do, and it should pay tax on its profits just as clearly as if it had generated the same total amount of income by pursuing the high-volume, low-mark-up option discussed above.

It is also irrelevant, in determining whether the Endowment is running a "trade or business," that it may have "set premiums at levels significantly higher than necessary" to cover its costs (Br. in Opp. 6) and that its insurance profits may "have far exceeded the value of any services which it * * * performed in the course of its administration of the plan" (Pet. App. 9a). To begin with, the Endowment's most valuable services are not the mechanical tasks of administering the plan, but its ability, acting as a middleman between suppliers and

consumers of insurance, to exploit its unique access to a pool of better-than-average insurance risks by endorsing, marketing and promoting the program. The group insurance plans involved in the Fourth, Fifth, and Sixth Circuit cases for similar reasons were also "highly profitable." See, *e.g.*, *Louisiana Credit Union League*, 693 F.2d at 533. The association in *Professional Insurance Agents* incurred expenses of only $12,000 to generate income of $176,000 from its insurance plans. Noting the wide differential between the one figure and the other, the Tax Court reasoned that the association "was being compensated not so much for the administrative services it performed as it was for endorsing the insurance company's product and providing a direct pipeline to its membership." 78 T.C. 246, 262 (1982).

More fundamentally, the Federal Circuit's analysis confuses the perspectives of the seller and the retail buyer. Middlemen invariably mark up the goods or services they sell; that is how they make money. The principal constraint on a middleman's ability to make profits is the market; if he seeks too high a mark-up above his costs, customers will buy elsewhere. Since ABA members have no access to the wholesale insurance market, it makes no difference whether the Endowment's profits are "equal" in some abstract sense to the value of the services it performs in delivering coverage to them. The relevant question, rather, is whether the retail price that the Endowment charges for participation in its group insurance plan is within the range of prices for comparable insurance in the retail marketplace generally.

A trial was held to answer that question, and the Claims Court found that the Endowment's "gross premiums were set with reference to the rates for other insurance products available in the market" (Pet. App. 29a (footnote omitted)). The Federal Circuit agreed with that finding, noting that the Endowment "set the premium at a level competitive with other insurance on the market" (*id.* at 4a). These factual findings mean that the retail price paid by the Endowment's members was

equal to the fair market value of the insurance they purchased, and that the Endowment's insurance operation was "conducted in a competitive profit-seeking manner" (*Carolinas Farm & Power Equipment Dealers*, 699 F.2d at 171). It thus constitutes a "trade or business" under the "profit motive" standard mandated by Section 513(c).[4]

3. In deciding whether the Endowment was engaged in a "trade or business," the "most telling factor" in the Claims Court's view was that "the insurance program was operated with the approval and consent of the ABA membership" (Pet. App. 38a). The court noted that the ABA's 300,000 members collectively have the power, by mounting a "grassroots movement" to oust the current leadership, "to change the method of operating the insurance programs" so that members would get the policy dividends back, leaving the Endowment with no profits whatsoever (*id.* at 39a). The most rational explanation of why ABA members refrain from doing this, the court stated, was that they "consider the Endowment to be engaged in fundraising, which they support" (*id.* at 41a, 42a). The court emphasized that the Endowment sells insurance exclusively to its members and their dependents, so that the insurance transaction is one "where both buyer and seller are consenting in the sense that one controls the other" (Br. in Opp. App. A11). "[T]he idea of profiting from oneself," the court said, "is almost a contradiction in terms" (*id.* at A13). The Claims Court accordingly held that "an enterprise that depends on the consent of its customers for its profits is not operating in a commercial manner and is not a trade or business" (Pet. App. 41a).

This reasoning is multiply flawed. It is of course true that one cannot derive a "profit," economically speaking, from dealings with oneself. But the Endowment is a corporate entity distinct from its members, and there is by no means a complete identity of interests between them. The Endowment deals with its members, *in their capacity as customers*, in a business-like manner and at arm's length. It markets its insurance to them aggressively, and it sets the price of its insurance as high as it can without driving them away. It treats its market, in short, much as other profit-maximizing enterprises treat theirs. Had the Endowment requested its members individually to return their dividends as an act of generosity, it would have dealt with them as a charity. But when it requires them to waive their dividends as a condition of buying insurance, it deals with them as a business.

The fact that ABA members theoretically have the power, by mounting a "grassroots movement" (Pet. App. 41a), collectively to change the Endowment's profit-maximizing strategy makes no difference whatsoever. The reality is that only 20% of ABA members buy

[4] In holding that the Endowment's high profit margins indicated the absence of a "trade or business," the courts below viewed those profits as showing that the Endowment's insurance activities were not "operated in a competitive, commercial manner" within the meaning of the Court of Claims' earlier decision in *Disabled American Veterans* v. *United States*, 650 F.2d 1178, 1187 (1981). See Pet. App. 8a-9a, 34a. That case involved a tax-exempt group that mailed out low-cost "premiums," such as maps and wristwatch calendars, to stimulate contributions to its semi-annual fund drive. The Court of Claims held that the group was not engaged in a "trade or business" to the extent that the "contribution required for the * * * premiums was substantially in excess of their retail value," with the retail value ranging from $0.85 to $1.50 (650 F.2d at 1187). In so ruling, the Court of Claims relied on Treasury Regulations providing that "where an activity does not possess the characteristics of a trade or business within the meaning of section 162, such as when an organization sends out low-cost articles incidental to the solicitation of charitable contributions, the unrelated business income tax does not apply" (Treas. Reg. § 1.513-1(b)).

Putting aside the question whether *Disabled American Veterans* was correctly decided, the courts below erred in relying on it here. Contrary to those courts' statements, the Endowment's insurance business *is run* in a "competitive, commercial manner" (650 F.2d at 1187). The prices it charges do not exceed the retail value of the insurance its customers buy. And the Regulations' exception for "low-cost articles" obviously has no application to the Endowment's insurance operation, which in 1980 administered $2.75 billion of life insurance alone.

insurance from the Endowment; the others presumably have insurance provided to them as a fringe benefit where they work, have found a better insurance deal elsewhere, or have chosen to do without insurance altogether. The 80% who do not buy the insurance presumably care little what the 20% are charged. Indeed, the 80% may well applaud the Endowment's educational endeavors and want those endeavors to be amply funded, particularly when the funds are provided by somebody else.

The prospect of a collective "grassroots movement" under these circumstances is utterly hypothetical. The Endowment sells insurance to *individuals*, not to an incorporate body politic. The Endowment sets the terms on which the insurance will be sold, and the individual member can take it or leave it. Given the cold facts and the business-like character of these relationships viewed individually, it makes no sense to say that, viewed collectively, they somehow add up to a sort of "group gift." See Br. in Opp. App. A6-A7.

The Claims Court's theory would open a loophole in the unrelated business income tax that Congress plainly has not sanctioned. The implications of the Claims Court's theory would not be confined to charitable organizations. The business leagues involved in the Fourth, Fifth and Sixth Circuit cases likewise sold insurance exclusively to their members, and thus "depend[ed] on the consent of [their] customers for [their] profits" (Pet. App. 41a). They would seem as well-situated as respondent to take advantage of the Claims Court's rationale. Nor would the application of that rationale be confined to sales of insurance. A tax-exempt organization could run hotels, apartment complexes, ski lodges, vacation resorts, travel agencies, and video sales outlets—ventures that would appear to all the world to be "a trade or business"—yet seek to avoid tax on its business profits by arguing that its customers were members who had the hypothetical power to "deny it any income if they so desired" (*id.* at 42a (emphasis omitted)). Nor is it self-evident why a

group would have to sell exclusively to its members in order to take advantage of the Claims Court's theory. Indeed, provided that a group's customer base included *some* members with the theoretical option to limit its profits, the group might sell to the world at large yet assert immunity from the unrelated business income tax.

The statute does not permit exempt organizations to conduct unrelated trades or businesses, yet escape tax on their profits simply by doing some or all of their business with their members. And insurance operations are no exception to this rule. To the contrary: the insurance operations of veterans' groups and fraternal beneficiary societies, which Congress addressed in 1969 and 1972, are invariably confined to providing insurance "to * * * members * * * or their dependents." I.R.C. § 501 (c)(8) and (19); see pages 19-22, *supra*. Yet Congress has made it clear that it regards such insurance activities as a "trade or business."

4. Contrary to the statements of the courts below (Pet. App. 9a, 45a-48a), finally, the Endowment's insurance activities fall squarely within the policy of the unrelated business income tax. Congress enacted that tax "to eliminate a source of unfair competition by placing the unrelated business activities of certain exempt organizations upon the same tax basis as the nonexempt business endeavors with which they compete" (Treas. Reg. § 1.513-1(b)). The Endowment's insurance operation—involving the administration of billions of dollars in policies, and enjoying the patronage of some 57,000 ABA members—is big business, and it provides a staple that few of its members do without. The Endowment thus competes directly with insurance brokers, plan administrators, and financial intermediaries nationwide that vie for the trade of 300,000 ABA members. Even credit card companies, oil companies, and department stores that offer insurance to their customers are viewed by the Endowment as sources of competition (C.A. App. 1189-1190). The privilege of stepping into the Endowment's shoes, with direct access to the ABA membership, "would be of *great* interest to a commercial venture" (*id.* at

1069 (emphasis in original)). Indeed, the Endowment has received, but has rejected, the bid of a for-profit insurance brokerage firm to take over administration of its plans for an annual fee (J.A. 87; C.A. App. 1173-1183).

The fact that the Endowment forbears from underselling all of its competitors, moveover, does not mean, as the Claims Court thought, that its insurance business has an "entirely procompetitive effect" (Pet. App. 48a). Quite the contrary: a tax-exempt entity need not underprice everyone else in the market to bring the policy of the unrelated business income tax into play. The incidence of that tax is premised, not upon a showing of predatory pricing in fact, but upon a statutory presumption that a tax-exempt group's operation of an "unrelated trade or business" presents a "sufficient likelihood of unfair competition to be within the policy of the tax" (Treas. Reg. § 1.513-1(b)). Indeed, given the market share that the Endowment's insurance program commands, it must be rather cold comfort to its competitors that its insurance could be even cheaper than it is. Particularly is that so since the Endowment exploits its tax-exempt status to gain an edge over its competition by telling its members that their premiums are partially tax-deductible.

II. RESPONDENTS ARE NOT ENTITLED TO DEDUCT ANY PORTION OF THEIR INSURANCE PREMIUMS AS A CHARITABLE CONTRIBUTION BECAUSE THEY FAILED TO PROVE THAT THE PRICE THEY PAID FOR THE INSURANCE EXCEEDED ITS FAIR MARKET VALUE

A. A Transfer To A Charity Is Not A "Contribution" Or "Gift" If The Transferor Receives, Or Expects To Receive, Commensurate Economic Benefits In Return

1. Section 170 of the Code affords an income tax deduction for a "charitable contribution," defined as "a contribution or gift" to or for a charitable, educational, or other qualifying group (I.R.C. § 170(c)(2)). The

phrase "contribution or gift" is not further defined in the Code or Regulations. However, Congress made clear in the legislative history of the 1954 Code that a transfer of property constitutes a contribution or gift "only if there [is] no expectation of any quid pro quo." H.R. Rep. 1337, 83d Cong., 2d Sess. A44 (1954). For purposes of the charitable contribution deduction, in other words, "gifts" are limited to "those contributions which are made with no expectation of a financial return commensurate with the amount of the gift." S. Rep. 1622, 83d Cong., 2d Sess. 196 (1954). See 2 B. Bittker, *Federal Taxation of Income, Estates and Gifts* ¶ 35.1.3, at 35-7 (1981).

Drawing upon this legislative history, the courts of appeals have consistently denied charitable contribution deductions to taxpayers who expect to receive, or do receive, an economic quid pro quo commensurate with the value of the property they transfer to charity. In *Sedam* v. *United States*, 518 F.2d 242 (1975), the Seventh Circuit denied a charitable deduction for a donation to an old-age home, where the "gift" was required as a condition of admitting patients. "It is at least clear," the court held, "that a payment is not a contribution or gift under section 170 if it is made with the expectation of receiving a commensurate benefit in return" (518 F.2d at 245). In *Goldman* v. *Commissioner*, 388 F. 2d 476 (1967), the Sixth Circuit denied a charitable deduction for a payment to charity, where the taxpayer received in return a raffle ticket which carried a chance to win a prize. The court concluded that the taxpayer "got just what he paid for" and hence had not made "a charitable contribution within the meaning of the statute" (388 F.2d at 480). In *Stubbs* v. *United States*, 428 F.2d 885 (1970), the Ninth Circuit denied a charitable deduction for a developer's contribution of land to a municipality, where the transfer was made in the hope of obtaining favorable zoning treatment. The alleged gift did not qualify for deduction under Section 170, the court held, because it "was in expectation of the receipt of certain

specific direct economic benefits within the power of the [city] to bestow" (428 F.2d at 887). Indeed, the Federal Circuit's predecessor on previous occasions itself denied charitable deductions where "the transferror had received, or expects to receive, a *quid pro quo* sufficient to remove the transfer from the realm of deductibility under section 170." *Singer Co.* v. *United States*, 449 F.2d 413, 423 (Ct. Cl. 1971).

2. A corollary of this rule is that a taxpayer's payment to a charity may be partially tax-deductible where he receives a return benefit that is *not* commensurate with the amount of his transfer. Such a "dual payment" is treated as in part a purchase of goods or services, and in part a charitable contribution. See, *e.g.*, *Goldman* v. *Commissioner*, 388 F.2d at 480; *Seed* v. *Commissioner*, 57 T.C. 265, 278 (1971); *Murphy* v. *Commissioner*, 54 T.C. 249, 254 (1970); *Arceneaux* v. *Commissioner*, 36 T.C.M. (CCH) 1461, 1464 (1977); Rev. Rul. 68-432, 1968-2 C.B. 104, 105; 2 B. Bittker, *supra*. ¶ 35.1.3, at 35-9. A common example of a "dual payment" is where a taxpayer buys a ticket to a concert held to benefit a symphony orchestra, with the ticket price being set at a level far in excess of the usual price of admission. See Rev. Rul. 67-246, 1967-2 C.B. 104, 107-108.

In order to establish such a "dual payment," the taxpayer must prove that the amount he paid to the charity exceeded the fair market value of the consideration that he received in return. See *Murphy* v. *Commissioner*, 54 T.C. at 254; *Arceneaux* v. *Commissioner*, 36 T.C.M. at 1464; Rev. Rul. 67-246, *supra*. For example, if a taxpayer buys a ticket to a benefit dinner or concert, "[t]he test is not the cost of the event to [the charity], but the fair market value of the consideration received by the purchaser of the ticket." Rev. Rul. 67-246, 1967-2 C.B. at 111. The "fair market value" of a product or service is the price at which it would change hands between a willing buyer and a willing seller in the "usual market" in which it is sold. Treas. Reg. § 1.170A-1(c)(2). Thus, if the product is customarily sold at retail, its "fair

market value" is its retail value. *Ibid.*; Rev. Rul. 80-233, 1980-2 C.B. 69; Rev. Rul. 67-246, 1967-2 C.B. at 110. Obviously, the difference between the cost of the quid pro quo to the seller and its retail value to the buyer cannot form the basis for an alleged "gift," since that difference is just a designation of the seller's customary profit.

To establish a "dual payment," the taxpayer must also show that he paid the "excess" amount with the intention of making a charitable contribution. See *Murphy* v. *Commissioner*, 54 T.C. at 254; *Arceneaux* v. *Commissioner*, 36 T.C.M. at 1464; Rev. Rul. 67-246, *supra*. In many cases, of course, the intent to make a charitable contribution will be evident from the surrounding circumstances. But "the intention to make a gift is * * * highly relevant in overcoming doubt in those cases in which there is a question whether an amount was in fact paid as a purchase price or as a gift" (Rev. Rul. 67-246, 1967-2 C.B. at 105).

B. Respondents Are Not Entitled To A Charitable Contribution Deduction Because They Failed To Prove That They Paid More For The Insurance Than It Was Worth

1. Consistently with the principles just outlined, the Claims Court correctly held that respondents could not deduct any portion of their insurance premiums as a charitable contribution unless they proved (a) that they had "bought goods or services for more than their economic value" and (b) that they had done so "with the intention that the excess be used to benefit [the Endowment's] charitable enterprise" (Pet. App. 49a). Since the Endowment required all ABA members to waive any claim to policy dividends as a condition of purchasing insurance, the "purchase price" that respondents paid was the gross premium that the Endowment charged. The court found that the Endowment in general set its "gross premiums * * * with reference to the rates for other insurance products available in the market" (*id.*

at 29a (footnote omitted)). Respondents individually testified that they regarded the Endowment's package as "reasonably or competitive[ly] priced" (J.A. 287; see *id.* at 263-264, 269-270). Three of the respondents failed to prove that cheaper insurance was available to them elsewhere during the tax years at issue (Pet. App. 54a-55a). The fourth, while demonstrating that cheaper insurance existed, offered no evidence that he knew about it during those years and had elected, for charitable reasons, to buy the Endowment's policy instead (*id.* at 55a-56a). The Claims Court accordingly held that respondents had failed to carry their burden of proof, since each had failed to demonstrate "that an equivalent insurance product was available to him for a lower price and that he by-passed that product because he wished to make a charitable contribution to the Endowment" (*id.* at 52a (footnote omitted)).

2. In reversing this holding, the court of appeals ruled that the inquiry conducted by the Claims Court—whether respondents could have purchased comparable insurance at a lower price—was "an incorrect definitization of the proper standard" (Pet. App. 19a). The correct legal test, rather, in the court of appeals' view, was "whether the transaction between the Endowment and [respondents] 'was of a business nature and not charitable' " based on "all the pertinent circumstances" (*id.* at 21a). Under that standard, the Federal Circuit said, respondents on remand could "present a *prima facie* case for the deduction * * * simply [by] mak[ing] a sworn assertion that they wanted to aid [the Endowment's] charitable endeavor and entered the Endowment's plan because it enabled them to do so" (*id.* at 22a). The burden of proof, the court said, would then shift to the government to "controvert that position and suggest factors showing that the transaction was basically business-oriented" (*ibid.*).

This reasoning is seriously flawed. As we have shown, the courts of appeals have uniformly held, consistently with congressional intent, that "a payment is not a contribution or gift under section 170 if it is made with the ex-

pectation of receiving a commensurate benefit in return" (*Sedam* v. *United States*, 518 F.2d at 245). The Federal Circuit completely ignored the economic comparability between what respondents paid for and what they got. Contrary to that court's statement, respondents cannot "present a *prima facie* case for [a charitable] deduction" simply by filing an affidavit averring "that they wanted to aid [the Endowment's] charitable endeavor" (Pet. App. 22a). To the contrary, a taxpayer who seeks to deduct part of an alleged "dual payment" must prove *both* that he paid an amount in excess of the value of any benefit received in exchange *and* that he intended to make a charitable contribution in the amount of such excess. The affidavit contemplated by the court of appeals might be relevant (while surely not dispositive) as to the latter point, but it is absolutely irrelevant as to the former. The question is not simply whether respondents "wanted to aid [the Endowment's] charitable endeavor" (*ibid.*), but whether they bought its insurance with "no expectation of any quid pro quo" (H.R. Rep. 1337, *supra*, at A44).

It has long been established that a taxpayer bears the burden of proving both the fact and the amount of his deductions. See, *e.g.*, *Helvering* v. *Taylor*, 293 U.S. 507, 514-515 (1935); *Welch* v. *Helvering*, 290 U.S. 111, 115 (1933); *Rockwell* v. *Commissioner*, 512 F.2d 882, 885 (9th Cir. 1975). In the case of charitable deductions based on alleged "dual payments," the courts have correctly applied this general rule by requiring the taxpayer to prove that his payment to charity exceeded the economic value of any return benefit received. See pages 42-43, *supra*. The court of appeals' proposed procedure, by requiring the government to "controvert" respondents' affidavits and prove "that the transaction was basically business-oriented" (Pet. App. 22a), would in effect shift to the Commissioner the burden of proving the reverse.

3. In the Claims Court, respondents did not contend that they should be relieved of their burden of proving that the gross premiums they paid exceeded the value of

the insurance they acquired. Rather, they contended that they had met this burden, on the theory that the "value" of the insurance they acquired was not its "market value" (Pet. App. 50a), but rather was "the net cost charged by the underwriter," that is, "the gross premium minus the dividend" (*id.* at 52a). This argument was based on the notion that ABA members, by mounting a "grass-roots movement" (*id.* at 41a), could "change the [insurance] arrangement at any time, thereby depriving the Endowment of the dividends" (*id.* at 52a).

Respondents' argument was a restatement of the "group gift" theory that the Endowment proffered in contending that it was not in a "trade or business." As we have shown (see pages 36-39, *supra*), that theory is entirely specious. While erroneously accepting that theory in the Endowment's case, the Claims Court rejected it in the case of the individual respondents, and did so correctly. The court noted that the decision whether to make a charitable contribution, like the decision whether to buy insurance to begin with, "is an individual one" (Pet. App. 53a). Thus, the fact that "the group as a whole could lower insurance rates is of little relevance to an individual member who must decide whether or not to participate in the insurance program as it is in fact structured" (*ibid.* (footnote omitted)). "Under the applicable law," the court held, "[a]n individual inquiry must be conducted" to determine whether a particular member "would buy the insurance regardless of whether [he] intended to make a donation" (*ibid.*).

The Claims Court in this respect was plainly correct. Respondents, like all other ABA members, as individuals have absolutely no choice about whether they will waive their policy dividends. If they will not waive their dividends, they cannot get insurance; it is simply part of the price of admission. The Endowment sets its price of admission fully cognizant of the valuable function it performs by assembling a pool of better-than-average insurance risks and negotiating favorable contracts with its underwriters. That in turn enables the Endowment to

make substantial profits while keeping its retail price competitive. Many lawyers elect to pay that price because they cannot find a better buy elsewhere. The simple fact of the matter is that ABA members, as individuals, do not have access to the wholesale group insurance market, but must pay the retail price, and the Endowment in this respect charges whatever the retail market will bear. Respondents "got just what [they] paid for" (*Goldman*, 388 F.2d at 480)—insurance at market prices—and they accordingly have no claim to any charitable contribution deduction.

CONCLUSION

The judgment of the court of appeals should be reversed, and the cases should be remanded to that court with instructions to reverse the Claims Court's judgment in the Endowment's case and to affirm the Claims Court's judgment in the cases of the individual respondents.

Respectfully submitted.

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